



A common mistake made by some taxpayers is confusing what is required for full tax deferral in an IRC Section 1031 tax-deferred exchange with calculations involved in determining the capital gain and capital gain taxes that would be owed absent a 1031 exchange. The requirements for full tax deferral are different than the capital gain tax and basis computations. The formulas for calculating a capital gain tax liability can be found in Asset Preservation's article, [Calculating Capital Gain](#).

WHAT ARE THE REQUIREMENTS FOR FULL TAX DEFERRAL IN A 1031 EXCHANGE?

If a taxpayer intends to perform a 1031 exchange which is fully tax-deferred, they must meet two simple requirements:

1. Reinvest the entire net equity (net proceeds) in one or more "like-kind" replacement properties;
- and -
2. Acquire one or more "like-kind" replacement properties with the same or a greater amount of debt.

An alternative approach for complete tax deferral is acquiring property of equal or greater value and spending the entire net equity in the acquisition. One exception to the second requirement is that a taxpayer can offset a reduction in debt by adding new cash to the replacement property closing in an amount that is the same or exceeds the reduction in debt.

WHAT IS BOOT?

The term "boot" refers to any property received in an exchange that is not considered like-kind. real property. Cash boot refers to the receipt of cash. Mortgage boot, which can also be referred to as debt relief, is a term describing a taxpayer's reduction in mortgage liabilities on the purchase of a replacement property or properties. Personal property received or non-like kind property is also considered boot in 1031 exchange transaction as only real property held for productive use in a trade or business or held for investment qualifies.

If a taxpayer receives cash or other property in addition to like-kind property, this may result in a taxable event. To determine the taxes that may be due, several steps are required. See Asset Preservation's article, [Calculating Capital Gain](#) for more details. First, the taxpayer's tax advisor must calculate the realized capital gain. Next, the amount of boot, money or other property received, along with any depreciation recapture, must be determined. The tax advisor will then need to determine the taxes owed for federal capital gain taxes, the depreciation recapture, state taxes (when applicable) and the Section 1411 net investment income tax (when applicable). Finally, a tax advisor will review the taxpayer's specific situation to see if there are additional tax issues that may offset any current capital gain tax liabilities.

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HQ 800.282.1031 | NY 866.394.1031
apiexchange.com | info@apiexchange.com